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APS

A subsidiary of Pinnacle West Capital Corporation

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July 26, 2006

Commissioner Jeff Hatch-Miller
Commissioner William Mundell
Commissioner Mike Gleason
Commissioner Kristin K. Mayes
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007-2996

Arizona Corporation Commission
DOCKETED
JUL 26 2006

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RE: APS Rate Case Docket No. E-01345A-05-0816

Dear Commissioner Jeff Hatch-Miller:

Attached please find a copy of Moody's Investors Service ("Moody's") recent report on Liquidity Risk Assessment of Arizona Public Service Company dated July 20th.

If you or your staff have any questions, please feel free to call me.

Sincerely,

Brian Brumfield
Supervisor
Regulatory Affairs

BB/bec

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Moody's Investors Service

Global Credit Research
Liquidity Risk Assessment
20 JUL 2006

Liquidity Risk Assessment: Arizona Public Service Company

Arizona Public Service Company

Phoenix, Arizona, United States

Broad Industry:	Public Utility
Specific Industry:	Integrated Electric Utility
Short Term Rating:	P-2

Contacts

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Opinion

Arizona Public Service Company's (APS: Baa2 senior unsecured, negative outlook) Prime-2 commercial paper rating reflects the relatively stable and predictable cash flow provided by a vertically integrated electric utility that serves a substantial portion of the state of Arizona, including the rapidly growing Phoenix area.

Prior to 2005, APS was generally able to meet all of its funding requirements for capital expenditures and payment of approximately $170 million in annual dividends to parent company Pinnacle West Capital Corporation (Pinnacle: Baa3 senior unsecured, negative outlook) with internal cash flow. Debt maturities were met by a combination of internal funds and capital markets refinancing. Increasing capital expenditures, delays in fuel cost recovery, and increased costs due to outages at the Palo Verde Nuclear Facility have resulted in an increased need for external financing. During 2005, Pinnacle issued approximately $250 million of common stock and infused the proceeds to APS. In January 2006, Pinnacle infused $210 million of proceeds received from the sale of its interest in the Silverhawk generating facility into APS.

For the year ended December 31, 2005, APS's cash from operations of approximately $721 million covered approximately 75% of the total of capital expenditures of approximately $795 million (including approximately $185 million for the purchase of the Sundance plant), and the payment of $170 million in dividends to Pinnacle.

In 2006, APS is planning to incur approximately $649 million of capital expenditures, with $148 million spent through 1Q 2006. APS also has $84 million of long term debt due in November. APS is meeting these needs through a combination of internal and external sources, including the equity infusions from Pinnacle noted above.

APS's pattern of cash flow is seasonal. The bulk of the utility earnings are received during the summer months due to the extreme weather conditions that exist in APS' service territory. As a result, peak commercial paper borrowings typically occur in the second and third quarters of each year. In a normal year, average commercial paper outstanding is approximately $100 million, as of March 31, 2006 short-term debt was approximately $85 million. For the past few years, there has been no commercial paper outstanding by year end. The utility has historically maintained very modest cash levels on its balance sheet; as of March 31, 2006, APS had reported cash and cash equivalents of approximately $77 million.

APS's commercial paper program is sized at $250 million and is currently supported by a $400 million revolving credit facility expiring in December 2010. The revolver has one financial covenant that requires the ratio of debt to total capitalization not to exceed 65%. As of March 31, 2006, as calculated in accordance with the credit documents, APS' debt to total capitalization was approximately 46%. The credit agreement does not require a Material Adverse Change (MAC) representation for revolver borrowings. No rating triggers exist in any APS credit facilities though interest costs may increase under various financing agreements if a downgrade occurs.